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No. 216

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1962.

REAL ESTATE CORPORATION, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Real Estate Corporation, Inc., the petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit entered in the above entitled case on March 1, 1962.

OPINIONS BELOW.

The opinion of the Tax Court is reported at 35 T.C. 610; and it and the judgment based thereon are reproduced at pages 45-57 inclusive of the transcript of the

record filed in the Court of Appeals for the Tenth Circuit, nine copies of which have been filed with the clerk under the provisions of this Court's Rule 21, paragraph 4.

The opinion of the Court of Appeals for the Tenth Circuit is reported at 301 F.2d 423; and the opinion with post-decision orders on denial of petition for rehearing is printed in the Appendix.

JURISDICTION.

The jurisdiction of this Court is invoked on the following grounds:

(a) The judgment of the United States Court of Appeals for the Tenth Circuit was entered on March 1, 1962, affirming the decision of the Tax Court which denied petitioner the relief claimed.

(b) On April 23, 1962, an order was entered by the United States Court of Appeals for the Tenth Circuit denying a petition for rehearing, but "correcting" the original opinion filed March 1, 1962.

(c) 26 U.S.C.A., Sec. 7482(a) (Act of August 16, 1954, c. 736, 68A Stat. 890); and 28 U.S.C.A., Sec. 1254 (Act of June 25, 1948, c. 646, 62 Stat. 928), are the statutory provisions believed to confer jurisdiction on this Court to review the judgment in question by writ of certiorari.

QUESTIONS PRESENTED.

As the Tax Court found, petitioner is an investment company formed to hold assets which could not be held by Riverview State Bank, a state banking corporation of Kansas, or its wholly owned subsidiary.

Petitioner did none of the things ordinarily associated with one holding property primarily for sale to customers

such as holding a real estate dealer's or broker's license, or soliciting purchasers; or maintaining an office; or advertising, or listing in the city directory. Petitioner did, under the stress of circumstances and without solicitation by it transfer various pieces of real estate for public purposes; or under threat of condemnation; or because investment value of a piece of property had ceased to exist; and it transferred property to builders and others to alleviate an acute shortage of housing and business locations brought on by the disastrous flood of July 13, 1951. It also bid at tax sales to protect the lien of municipal securities it had acquired at the time it was formed, or to reinvest the proceeds of transferred property.

When all assets acquired by petitioner on its formation were capital assets—do the activities listed above constitute a second business of holding property primarily for sale to customers in the ordinary course of business, thus causing that property to lose its capital asset status so that on gain from these transfers the petitioner should be excluded from and denied the benefit of the capital gains tax under the Internal Revenue Code of 1939, 26 U.S.C., 1952 ed., Sec. 117?

STATUTE INVOLVED.

(26 U.S.C., 1952 ed., Sec. 117, pp. 158, 162)

"Sec. 117. Capital Gains and Losses.

(a) Definitions.—As used in this chapter—

(1) (as amended by Sec. 210(a), Revenue Act of 1950, c. 994, 64 Stat. 906) Capital assets.—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(A) * * * property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

* * *

(j) (as added by Sec. 151(b), Revenue Act of 1942, c. 619, 56 Stat. 798) Gains and Losses from Involuntary Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.—

(1) Definition of property used in the trade or business.—For the purposes of this subsection, the term 'property used in the trade or business' means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not * * * (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

CONCISE STATEMENT OF THE CASE.

There was no conflict in the evidence; and this was conceded by the respondent on brief in the Court of Appeals at page 8, Note 1.

The Riverview State Bank of Kansas City, Kansas, a state banking corporation, invested in municipal securities of the City of Kansas City, Kansas, called special tax bills. The special tax bills were issued to contractors to pay for public improvements.

Each special tax bill became a lien on a particular lot in a benefit district, payable in not to exceed ten annual installments.* If the general taxes due were not

*General Statutes of Kansas, 1935, Sec. 13-1079, p. 224, in pertinent part provides:

"* * * said governing body shall provide for the payment of the cost thereof by special tax bills against the property charged therewith, payable in not to exceed ten annual installments. * * *"

paid there was a foreclosure of the general tax lien and to protect its investment and the lien of special tax bills the Bank was forced to bid at tax sales. Consequently the Bank acquired real property which it could not hold indefinitely under Kansas law.

When state and federal bank examiners objected to the acquisition of real property by the bank, it transferred the special tax bills and the land to a wholly owned subsidiary General Securities Corporation, Inc. The same objections were made to General Securities Corporation, Inc., so a group of individuals, all but one being stockholders of Riverview State Bank, formed petitioner Real Estate Corporation, Inc., in 1949, as an investment company. Petitioner purchased all the assets including land and special tax bills. (10th Circuit Record, pp. 23, 24, 26, 27 and 28).

The purpose of Real Estate Corporation, Inc., petitioner was to hold the assets for their investment advantages. (Tax Court Opinion, 10th Circuit Record, page 49; 10th Circuit Court of Appeals Opinion, 301 F.2d at p. 426, Appendix p. A3).

From time to time petitioner purchased land at tax sales to protect the lien of special tax bills and thus one capital asset—a special tax bill—was converted into another capital asset, a piece of land.

In the years 1950, 1951 and 1952, petitioner engaged in the transactions shown in the chart printed in the Tax Court opinion (10th Circuit Record at page 47), and in the Court of Appeals opinion. (Appendix at page A2, 301 F.2d at page 425).

On nonconflicting evidence the Tax Court found that petitioner was engaged in the business of holding real estate for investment purposes—but that it was also engaged in the business of holding unimproved land primarily for

sale to customers in the ordinary course of business. (10th Circuit Record, page 50).

On nonconflicting evidence the Tax Court also found that little time was devoted by petitioner to buying and selling real estate, there being no soliciting, advertising or listing and it did not engage in any activities for the purpose of making the land more saleable. (Tax Court Opinion, 10th Circuit Record, page 51).

Many of the transfers of investments in land from petitioner were for public purposes—to the University of Kansas through the K.U. Medical Center; to the city for the pistol range for the Kansas City, Kansas, Police Department; there were condemnations by the City of Kansas City, Kansas; there were transfers to the Kaw Valley Drainage Board for flood protection; transfers to the Kansas Toll Road Authority and to the Kansas Highway Department; to the Kansas City, Kansas, Board of Public Utilities; to the Board of Education; to the Citizens Military Committee for the National Guard Armory; and to the Union Pacific Railroad Company under threat of condemnation. (10th Circuit Record, pages 29 and 30).

The purpose and pattern of the petitioner is aptly epitomized in the following testimony of its President:

> "13. The purpose of Real Estate Corporation is to accumulate income out of the investments it makes (136) (138); to develop rentals and lease rentals for its property as the ordinary income of the corporation —the liquidation of investments is incidental and not a part of the business of the company—when payments are made, the proceeds are invested in other property for the primary purpose of the corporation, that is, the holding of real estate for its investment advantages (26)." (10th Circuit Record, page 24).

> "72. Pattern of the Real Estate Corporation investment was that numerous lots located over the City

of Kansas City, Kansas, were acquired from the General Securities Corporation. A certain amount of those properties developed into revenue producing properties (135). It hasn't been possible to lease every property or improve every piece. The purpose of the corporation is to accumulate income out of the investment which had been made. Not every one turns out profitably—leases made have produced a revenue over the period of ten or eleven years of over 72% of the gross revenue. Real Estate Corporation is not in the real estate business—and never has been—never represented a client as agent—or wrote an insurance policy—or did any of the things a real estate firm does (137). We have invested in real estate—income from leases represents 72.58 per cent of the gross income of the corporation since 1949 (138)." (10th Circuit Record, page 44).

The respondent conceded and the Tax Court found that petitioner was in the business of leasing improved real estate. (10th Circuit Record, page 53) but also held that petitioner was engaged in a second business of holding unimproved land primarily for sale to customers in the ordinary course of business. (10th Circuit Record, pages 50, 54).

FEDERAL JURISDICTION IN THE COURT OF FIRST INSTANCE.

The Court of first instance was the Tax Court and its jurisdiction is conferred by 26 U.S.C.A., Sec. 7442 (c. 736, 68A Stat. 879); 26 U.S.C.A., Sec. 6213(a) (c. 736, 68A Stat. 771); and 26 U.S.C.A., Sec. 6214 (c. 736, 68A Stat. 773), all in the Act of August 16, 1954.

REASONS FOR GRANTING THIS WRIT.

1. It is important to investors and others to know whether the liquidation of investments under the circumstances of this case deprives them of the benefit of the

capital gains provisions of the Internal Revenue Code, and this question has not been decided by this Court.

2. By basing their decisions primarily on frequency and continuity of transactions, the decisions of the Tax Court and the Court of Appeals for the Tenth Circuit are in conflict with:

(a) The decision of the 5th Circuit Court of Appeals in *Lobello* v. *Dunlap*, 210 F.2d 465, where it was held that frequency and continuity of sales by themselves do not conclusively cause assets to lose their character as capital assets but may be offset by other facts, citing *Victory Housing No. 2* v. *Commissioner of Internal Revenue*, 10th Circuit, 205 F.2d 371.

(b) The decision of the 10th Circuit Court of Appeals in *Victory Housing No. 2* v. *Commissioner of Internal Revenue*, 205 F.2d 371, where it was held:

> "The fact that 42 units were sold over a period of six months does not establish a real estate business or the sale of property in the ordinary course of such a business." (p. 373).

(c) The decision of the 5th Circuit Court of Appeals in *Cole* v. *Usury*, 294 F.2d 426, where it was said:

> "There are many cases where this Court has held the taxpayers entitled to capital gains treatment in which the frequency and continuity of sales were more intense than in the present case; e. g. Goldberg v. Commissioner of Internal Revenue, 5 Cir., 1955, 223 F.2d 709 (90 Houses and lots in one year); Ross v. Commissioner of Internal Revenue, 5 Cir., 1955, 227 F.2d 265 (235 lots in 38 transactions in 2 years); Consolidated Naval Stores v. Fahs, 5 Cir., 1955, 227 F.2d 923 (over 100 sales totaling 200,000 acres in one year)." (p. 429).

For the three years in issue here there were only 52 transactions involving transfers from petitioner and only 18 transactions involving transfers to petitioners. (10th Circuit Court Record, page 47).

(d) The decision of the Ninth Circuit Court of Appeals in *Austin* v. *Commissioner of Internal Revenue*, 263 F.2d 460.

3. The Court of Appeals applied the following erroneous standards for decision:

(a) In ruling that it was bound by findings of the Tax Court which were made on uncontroverted testimony and applying the principle of Rule 52(a) of the Federal Rules of Civil Procedure, because in *U.S.* v. *DuPont De-Nemours & Co.*, (1957) 353 U.S. 586, 1 L. Ed. 2d 1057, this Court said:

> "N. 28. There is no significant dispute as to the basic facts pertinent to the decision. We are thus not confronted here with the provision of Fed. Rules Civ. Proc., 52 (a), that findings of fact shall not be set aside unless clearly erroneous." (353 U.S. at page 598).

The DuPont decision was followed by this Court in *U. S.* v. *Mississippi Valley Generating Co.*, (1960) 364 U.S. 520, 5 L. Ed. 2d 268.

(b) In ruling that

> "* * * If the findings of the Tax Court find support in the record, we may not reverse because we, in the first instance, might have reached a different conclusion." (Appendix page A5, 301 F.2d at page 427).

and that

> "We feel that the Tax Court's conclusions that the corporation was engaged in a second business of buy-

ing and selling these vacant lots in the ordinary course of business finds support in the record." (Appendix p. A7, 301 F.2d at page 428).

But in *Cravens* v. *Commissioner of Internal Revenue*, 272 F.2d 895, 898, the 10th Circuit Court of Appeals' opinion reads in part:

> "Here the basic facts are not in controversy * * * A consideration of the nebulous distinctions between findings of fact and conclusions of law is not helpful. There are presented no conflicts of evidence or inference. *We must take the record and determine whether a mistake has been made.*" (Italics ours).

This is in accord with the decision of this Court in *U. S.* v. *U. S. Gypsum Co.*, (1948) 333 U.S. 364, 92 L. Ed. 746, where the following statement appears:

> "A finding is clearly erroneous when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been made." (333 U.S. at p. 395).

(c) In ruling that the decisive test was whether petitioner engaged in

> "* * * the purchase and sale of real estate in the ordinary course of business." (Appendix p. A6, 301 F.2d at page 427).

and a

> "* * * second business of buying and selling these vacant lots in the ordinary course of business * * *" (Appendix page A7, 301 F.2d at page 428).

But the statutory test is

> "* * * properly held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; * * *" (26 U.S.C.A., Sec. 117).

The property in question was held—but not for sale—or to customers—or in the ordinary course of petitioner's investment business.

Furthermore, the Court of Appeals has in effect ruled that "primarily" means "ultimately". This makes appropriate the following statement of the 5th Circuit Court of Appeals in *Hillard v. Commissioner of Internal Revenue*, 281 F.2d 279, at page 283:

> "To hold, as we would be required to hold to sustain the Commissioner's position, that 'primarily' means 'ultimately' would be out of keeping with the purpose and intent of the statute."

(d) In ruling that, in the original opinion, with reference to "special tax bills":

> "These were short-term paper and certainly did not constitute capital assets." (Original Opinion, p. 10; Appendix, p. A6).

On petition for rehearing (Certified transcript, p. 5) the Clerk was instructed to strike the statement from the opinion on file. (Certified transcript, p. 6, Appendix, pp. A9, A10).

As pointed out in the petition for rehearing, this statement was inaccurate. (Certified transcript, p. 5; Petition for Rehearing, p. 9).

The Court of Appeals made another erroneous statement in its original opinion—that there had been no single instance of refusal by petitioner to sell. (Original opinion, p. 11, Appendix, p. A7). It also was stricken (Appendix, p. A10).

Acquiescence cannot be given to the Court of Appeals' statement that these inaccuracies were "* * * not necessary to a decision of the case * * *"; or did "* * * not require a different result"; or to the statement that

"A careful reading of the opinion supports this conclusion and makes the philosophy thereof clear and unmistakable * * *". (Certified transcript, p. 6; Appendix, p. A10).

On the contrary, it is respectfully asserted that these statements do require a different result, for they show that the conclusions in the opinion of the 10th Circuit Court of Appeals are based on fallacious premises.

CONCLUSION.

The issue presented here under the circumstances of this case has not been decided by this Court either under the Internal Revenue Code of 1939 or the Internal Revenue Code of 1954.

The importance of the question for decision; the conflict between the decision sought to be reviewed and the decisions of other Courts of Appeal; and the failure of the 10th Circuit Court of Appeals and the Tax Court to follow standards established by this Court have been demonstrated.

Only as recently as April 30, 1962, it was said in the opinion of this Court in *Commissioner of Internal Revenue* v. *Bilder*, (No. 384—October Term, 1961) U.S. , 8 L. Ed. 2d 65,

"* * * Because of a subsequent contrary holding by the Court of Appeals for the Second Circuit * * * and the need for a uniform rule on the point, we granted certiorari to resolve the conflict." (p. 67).

In *Putnam* v. *Commissioner of Internal Revenue*, 352 U.S. 82, 1 L. Ed. 2d 144, is the following ruling of this Court:

"* * * Because of an alleged conflict with decisions of the Courts of Appeals of other circuits, we granted certiorari." (352 U.S., p. 84).

An important question of federal law is involved; and the question has not been but it should be settled by this Court for it will recur not only under the Internal Revenue Code of 1939 but also under the Internal Revenue Code of 1954.

It is therefore very respectfully submitted that the petition for certiorari should be granted.

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